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¶D. 2008 ANKARA 1744

¶1. (SBU) Summary. The number one concern of Turkish banks today is credit risk from Turkish Lira (TL) and foreign exchange (FX) loans made to the private sector. That risk is manageable now, but all banks, the Central Bank, and the Banking Regulator (BDDK) are all watching trends in non-performing loans (NPL) carefully. Turkish banks benefited from the painful reforms they made after the financial crisis of 2000-2001. The number of banks declined from 80 in 2001 to 56 today, and the BDDK expects to see some additional consolidation. Across the board Turkish banks now maintain high capital adequacy ratios (CAR) averaging 18 percent, which is well above the Basel II standard of eight percent. Central Bank stress testing shows that even if non-performing loans increase from the current average of four percent to 13 percent, banks will still be able to maintain an average CAR of 12 percent. To date, companies have been able to roll over or repay their debts, and FX loans are available, albeit at higher rates and from fewer sources. End summary.

NPL Concerns and Auto Stimulus

¶2. (SBU) In February, BDDK President Tevfik Bilgin warned banks against distributing dividends from 2008 earnings and encouraged them instead to use profits to bolster their capital base. BDDK has set 12% as the minimum threshold for CAR. If a bank drops below that level, it cannot open branches or acquire subsidiaries. Despite their healthy CAR levels, banks are making few loans. Instead, they are minimizing credit risk by using deposits to buy Turkish Treasury bonds instead of lending to businesses or individuals. Government bonds constituted just 27% of banks, total assets at the end of 2008 and reached 52% in the first two months of 2009, showing banks' aversion to lending. Overall loan demand for new investment is down, due to concerns about the economy and stagnant inventories, but companies still need working capital. In past crises, company owners took personal loans for working capital or companies helped each other by extending receivable repayment to 60 or 90 days.

¶3. (U) One reason for banks' aversion to lending is the continuing growth in NPLs, which increased 1.3% per week in the first two months of 2009. The banking sector's NPL ratio was 3.6% at the end of 2008, and has increased to 4.21% as of March 2009. While NPLs still constitute only four percent of total loans outstanding, their continued increase makes banks very cautious about lending. The heaviest NPL levels are in

credit cards (7.7%), loans to SMEs (4.3%), and auto loans (7.5%). The first two categories are generally unsecured, but auto loans are made on only 75% of the car's value and secured by the vehicle. Meanwhile, NPL ratios for retail loans were 3.68% at the end of 2008 and have grown slightly in 2009. Defaults on housing loans (1.5%) remain manageable. Turkey does not have a sub-prime mortgage problem because of timing and luck. It took the Parliament years to refine the mortgage law, so Turkey did not get into derivatives or mortgage-backed securities and does not have a significant secondary mortgage market.

Loan Volumes

¶4. (U) Total loans in the banking sector reached 368 billion TL ($216 billion) in 2008, marking a 29% year-on-year increase, with FX loans constituting 29% of the total. In 2008, banks in Turkey provided $45 billion in FX loans, and an additional $25 billion in FX loans was extended by foreign banks and Turkish bank branches outside the country. The total FX debts of the non-bank corporate sector is $95.6 billion as of January 2009 according to the Central Bank. According to the same data, total bank and non-bank debt as of January 2009 is $138 billion. FX loans are supposed to be restricted to borrowers who have foreign exchange earnings. However, some individuals and non-exporting companies found a way to circumvent the restrictions by putting up FX held in Turkey or overseas as collateral. FX borrowing became less attractive in late 2008 and early 2009 as the lira dropped in value against the dollar and the euro. and made repayment of FX loans much more expensive.

¶5. (SBU) The banking sector,s FX debt payments are less of a concern in 2009. As of January 2009, total bank debt is $29.5 billion, with $4.9 billion due within one year. The sector's total foreign borrowings in 2008 were $60 billion. Turkish banks managed to roll over 55% of that amount and repaid the balance. BDDK's Vice President, Sabri Davaz, does not expect banks to have significant problems rolling over or repaying their debts in 2009.

¶6. (SBU) The lack of sophisticated monetary instruments in the Turkish banking sector has been an advantage of late, with public exposure to leverage lower in Turkey than in most other countries. According to Akbank research, Turkish banks have a low penetration of banking products to consumers, which provides an opportunity for further growth when the economy picks up. Turkish household debt is also relatively small compared to EU levels. Turkish household debt to GNP was 11% at year end 2007, compared to a ratio of 56% for EU households. Selim Guray Celik, Vice President of state-owned Ziraat Bank, says Ziraat has a low 1.6% level of NPLs, because more than 50% of its loans are made to civil servants and pensioners whose loan payments are automatically drawn from their Government-deposited salaries or pensions held at Ziraat.

Looking to the Post-Crisis Future

¶7. (SBU) Ekrem Keskin, Secretary General of the Banks' Association of Turkey, said the main risks the banking sector will face in 2009 and beyond are: uncertainties in the international environment, reliance on external borrowing, pressures on FX liquidity, contraction in economic activity, rising costs of financing in the private sector, ownership changes in banks in Europe, interest rate risk, and increases in non-performing loans. We discussed each of these with our contacts at BDDK, the Central Bank, and several of the biggest banks in Turkey. None are unduly concerned about these risks, and all are pleased that Turkey stayed out of the muck experienced by American and European banks.

¶8. (U) Interest rates on loans have not declined much despite Central Bank rate cuts, but CB Vice Governor Erdem Basci expects rates to trend down slowly. The banks' strong liquidity conditions will pave the way for decreasing loan interest rates in the coming periods. The CB lowered its

benchmark overnight borrowing rate--now 10.5%--another 100 basis points on March 19. The CB has cut a total of 625 basis points from the overnight borrowing rate since November ¶2008.

¶9. (U) The Turkish Banking sector has long been suffering from maturity mismatch with deposit maturity of approximately 32 days and lending maturities of one year or more. In recent months, this problem seemed to stabilize as banks bought government securities with various maturities instead of extending loans. Once the economy starts to recover, maturity mismatch will again be a problem if banks cannot find ways to attract longer term deposits.

¶10. (SBU) Comment: Turkish banks have been both lucky and smart. Industry reforms after the 2000-2001 crisis were painful and expensive but the industry is well situated now to withstand some shock. High capital adequacy ratios and an effective banking regulator are good buffers against industry problems. We and everyone in the industry will closely watch NPL trends, which remain the most significant risk for the industry. We will also watch for renewed signs of normal banking operations and the lending needed to jump-start the economy once the world starts to recover from its economic recession. According to BDDK data, the number of branches in the banking sector increased by 1,108 in 2008, with a nine percent increase in the number of employees. Turkish banks opened a total of 268 branches in the last three months of 2008, and hired 1,140 new employees. This significant growth just as the Turkish and world economies were slowing remains unexplained. It should, however, position Turkish banks to expand lending quickly as soon as business conditions improve. End comment.

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